Leicestershire County Council Pension Fund

2016 Formal Valuation

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Overview of a valuation

- Actual cost of a Scheme will depend on the pensions actually paid
- Pensions actually paid depends on benefit structure, inflation and longevity
- A valuation estimates how much money will be needed to pay the pensions
- Estimate is based on assumptions
  - projected amounts of benefit payments
  - projected probability of benefits being paid

How we do a valuation

- We measure the financial position
  - using economic indicators
  - over the long term
  - consistent with the market value of assets
- We manage contributions
  - by modelling economic scenarios
  - over the long term
  - to set stable and affordable costs

How we do a valuation

2016 valuation

- **Measurement** of the funding level
  - **Current assets**: Market value
  - **Current liabilities**: Prudent investment returns
- **Management** of contribution rates
  - **Future assets**: Probability of better returns
  - **Future liabilities**: Bond yields rise in the future?

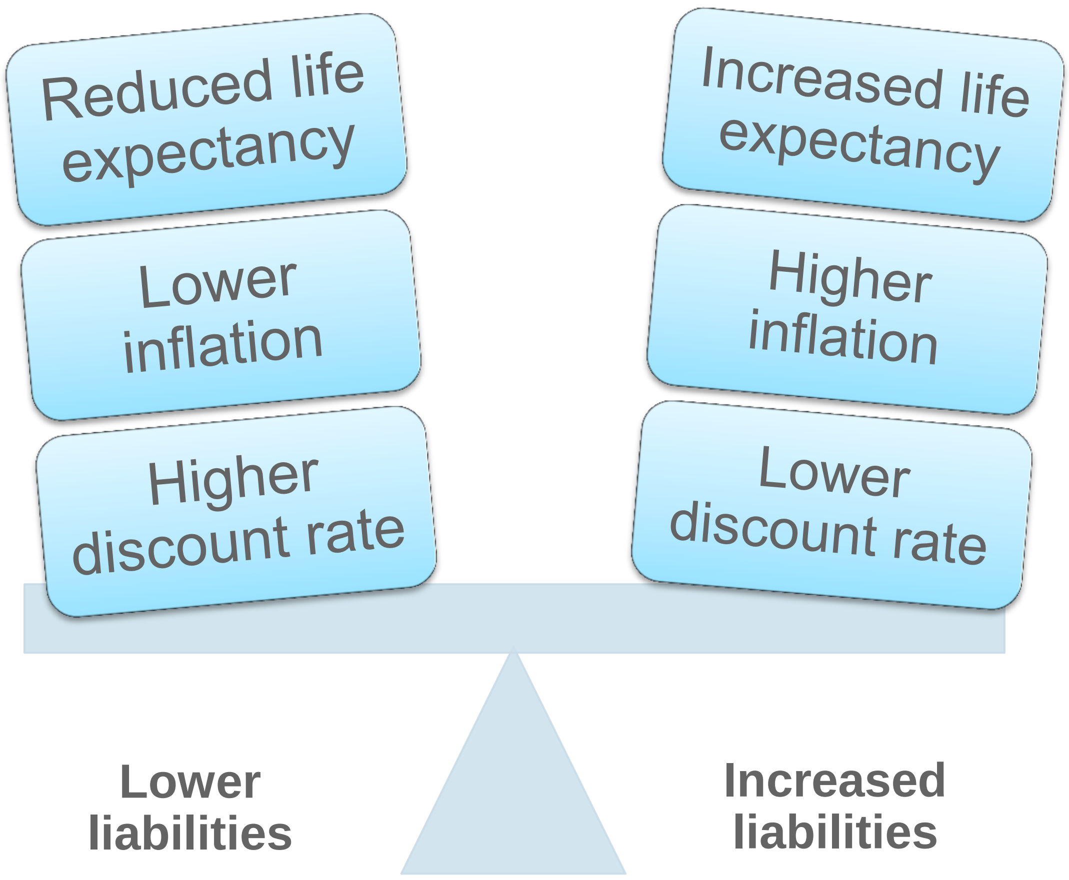
Key financial assumptions

- Discount rate – based on future asset returns
- Inflation – long term, based on market yields
- Salary growth – linked to RPI, long term
- Pension increases – CPI

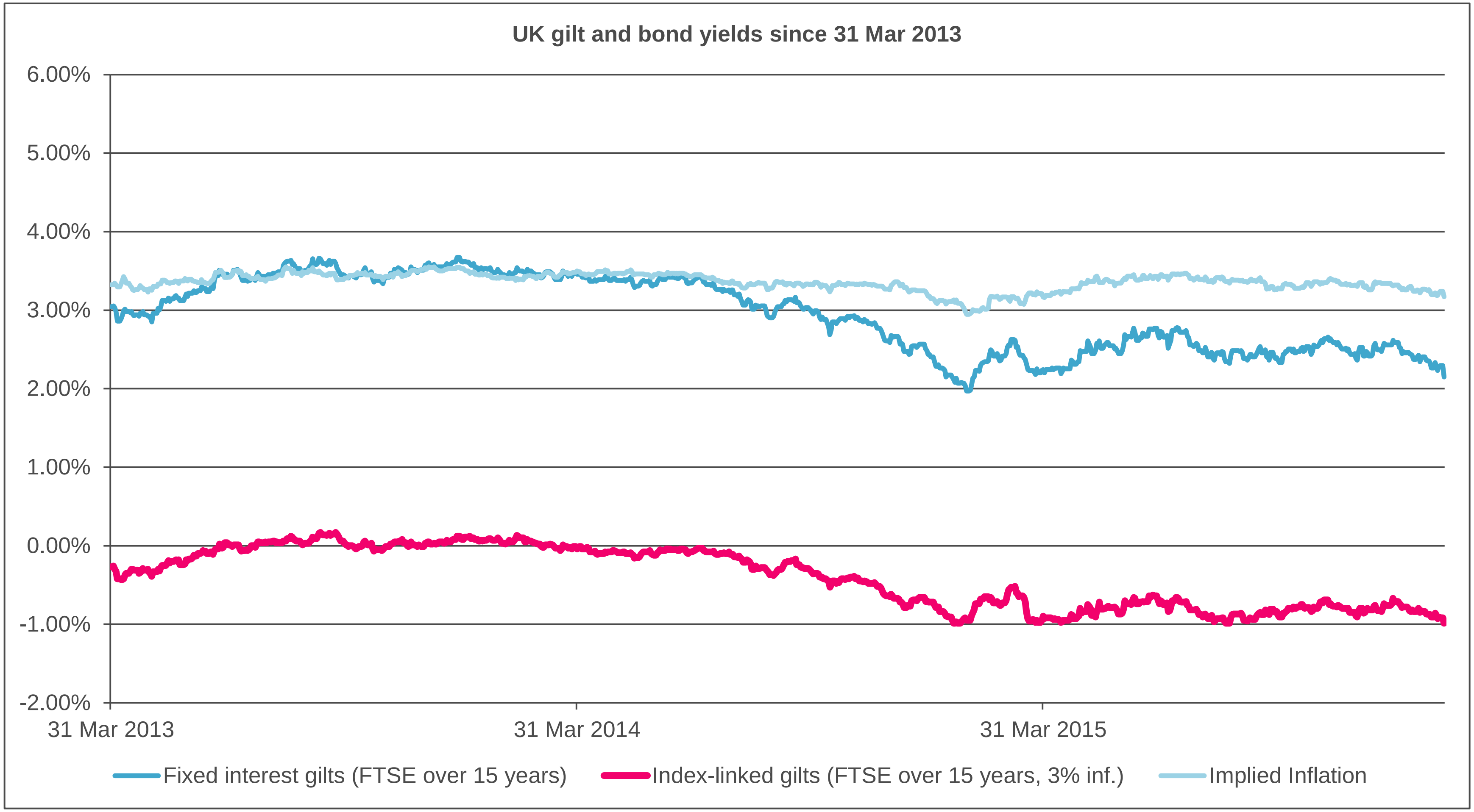
- Longevity – bespoke survival curves from Vita

Assumptions less important for contribution rates

Impact of changes to assumptions



Market conditions



Discount rate assumption

- Prudent estimate of future investment returns
- Discount rate = gilt yield (long term) + asset outperformance assumption (AOA)
- Why gilt yields? – begin with lowest risk investment return and allow for assets held
- AOA – *prudent* estimate of expected investment return in excess of gilt yields, taking into account Fund’s actual asset split

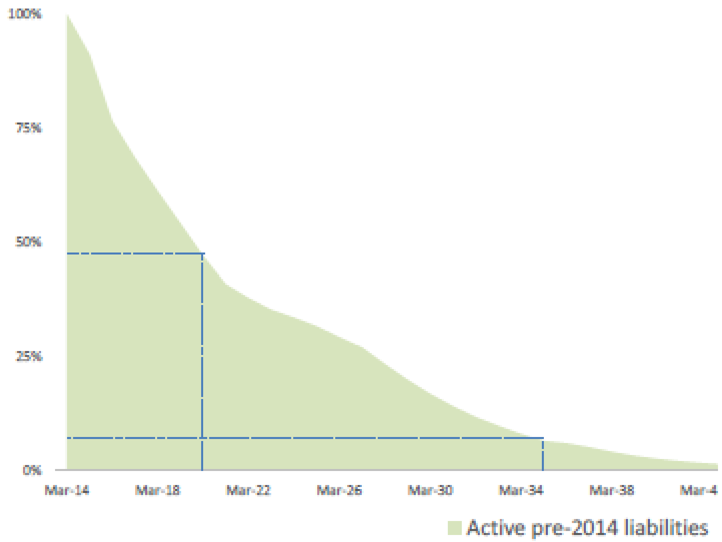
Recommend – Discount rate of gilt yield + 1.8% p.a.

Salary growth assumption

- Decreasing in importance as final salary benefits run off (because only relevant for pre-2014 service)
- No impact on future service cost – CARE scheme
- Typically based on RPI plus a margin (to reflect what has actually happened)
- Promotional salary scale is set separately

Salary growth analysis

- Final salary benefits run-off
- Public sector pay freeze!



	Scenario
Pay growth (per annum) - Short term (to 31 March 2020) - Long term (from 1 April 2020)	 1% RPI + 1.0% (4.4%)
Single equivalent 2016 valuation assumption - Nominal - Relative to RPI	 3.4% RPI
Reduction in past service deficit	**c.£170m**
Increase in funding level	**c.4%**

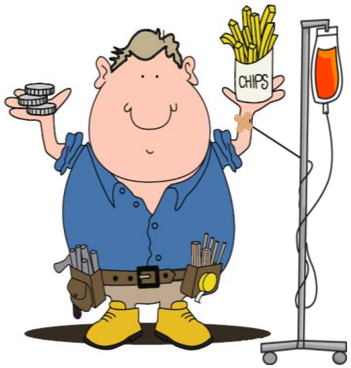
Recommend - Salary increases of RPI p.a.

Pension increase assumption

- Pension increases are CPI
- Long term expectations, not current
- No CPI market indicators available
- Based on RPI less a margin
- 1% is the accepted standard

Pension increases of RPI less 1% p.a.

Differences in longevity



Life expectancy from 65: **12.9 years**

Life expectancy from 65: **21.9 years**

- Unhealthy lifestyle postcode

Lifestyle 3.5 years

- Healthy lifestyle postcode

- Low affluence

Affluence 3 years

- High affluence

- Ill health retirement

Health 2 years

- Normal health retirement

- Manual worker

Occupation <1 year

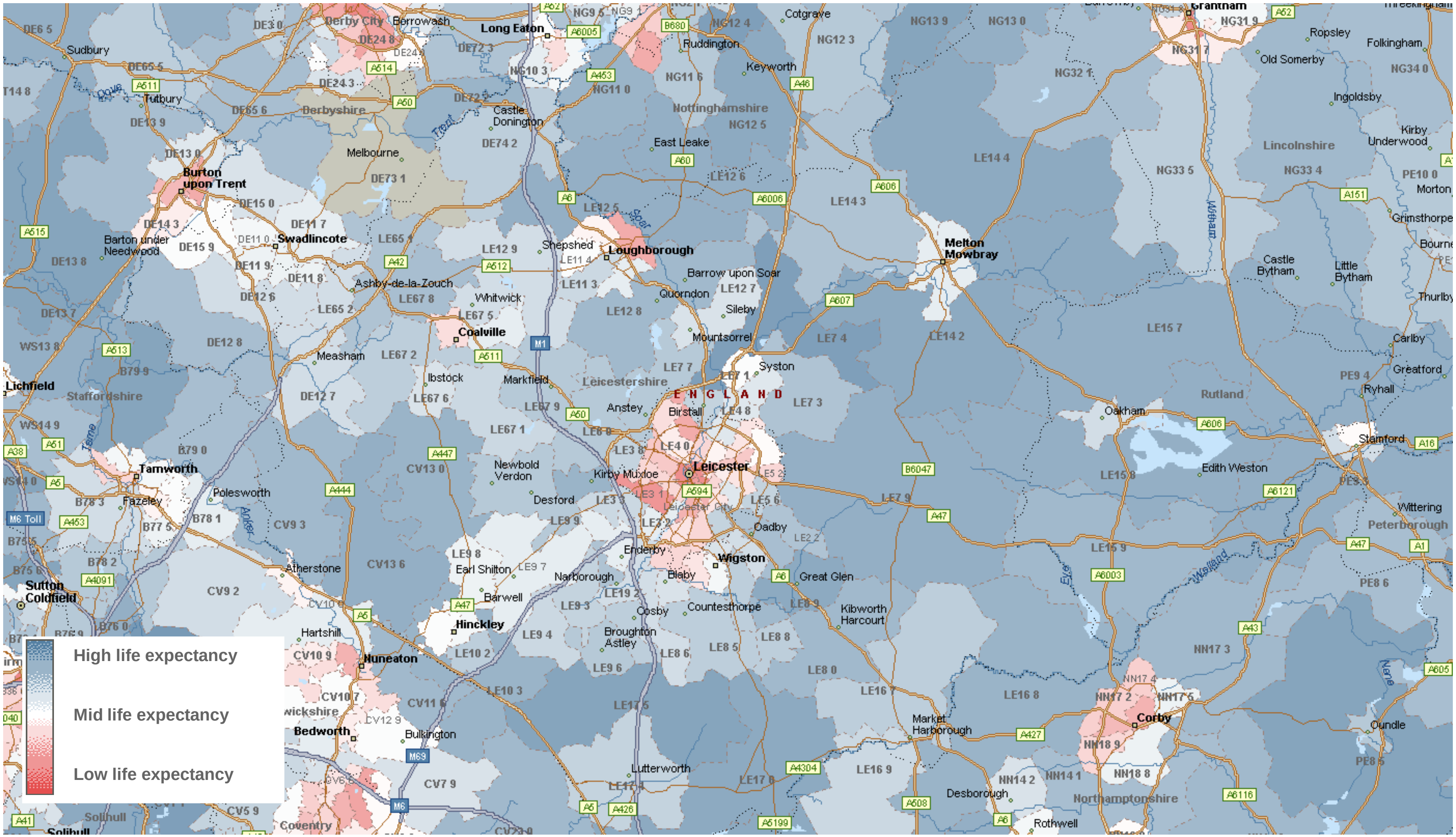
- Non-manual worker

No such thing as a typical member

No such thing as an average scheme or employer

Source: Club Vita's analysis based on membership as at 31 January 2014. Life expectancies shown from age 65, and are based upon Club Vita's baseline longevity calibrated to the period 2010-2012.

The postcode effect



Source: Club Vita research based on VitaBank as at January 2015

Measurement - Current funding target

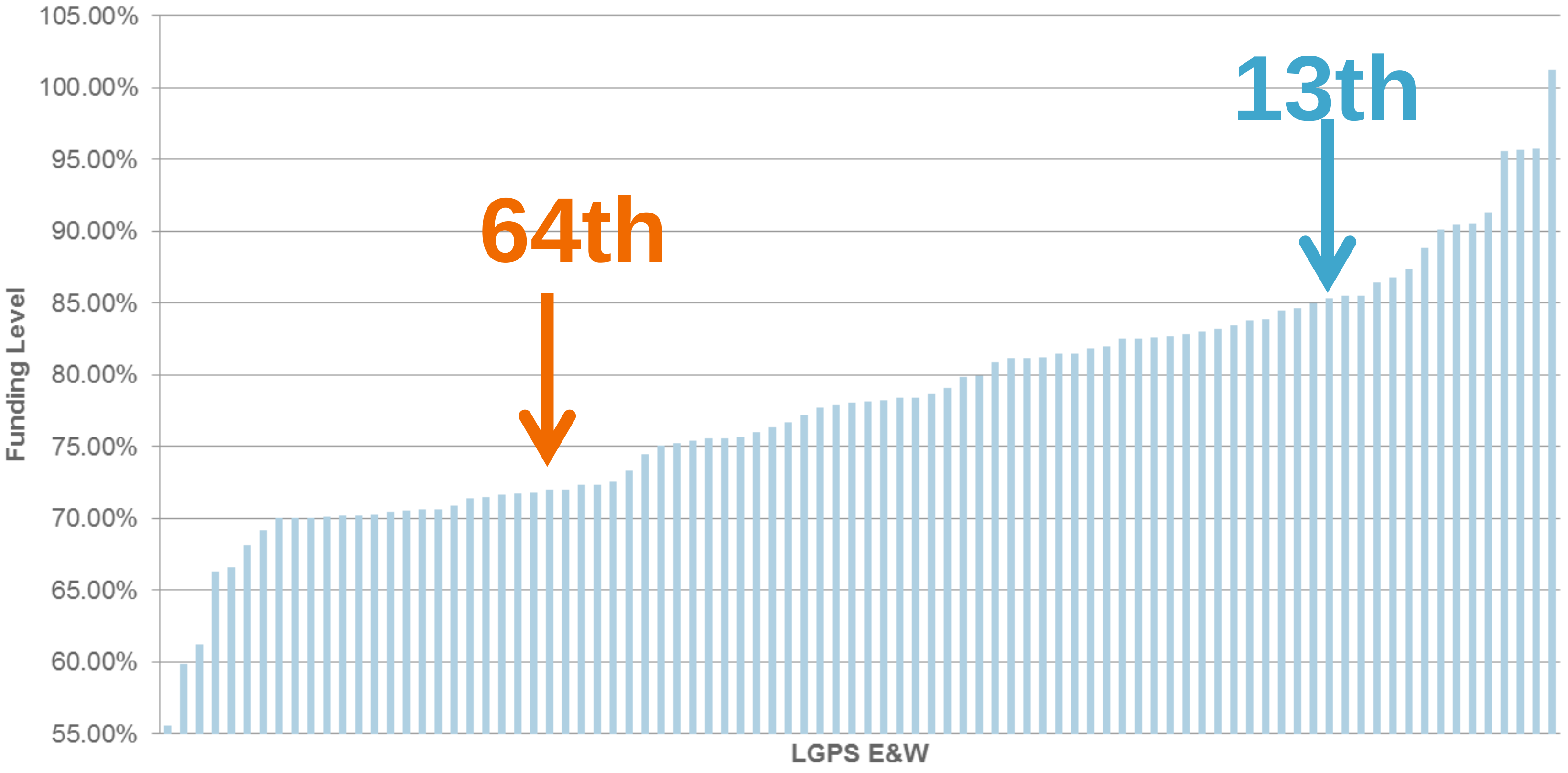
Assumption	2013 approach	2016 approach	Impact on funding level compared with 2013	Impact on funding level - market conditions*
Discount rate	AOA = 1.8%	AOA = 1.8%	No change	Decrease of 13%
Salary growth	RPI + 1%	RPI	Increase of 4%	Increase of 1%
Pension increases (CPI)	RPI - 0.8%	RPI - 1%	Increase of 4%	Increase of 2%

Overall – little change from assumptions

*Based on current market conditions

Beware of heroic assumptions!

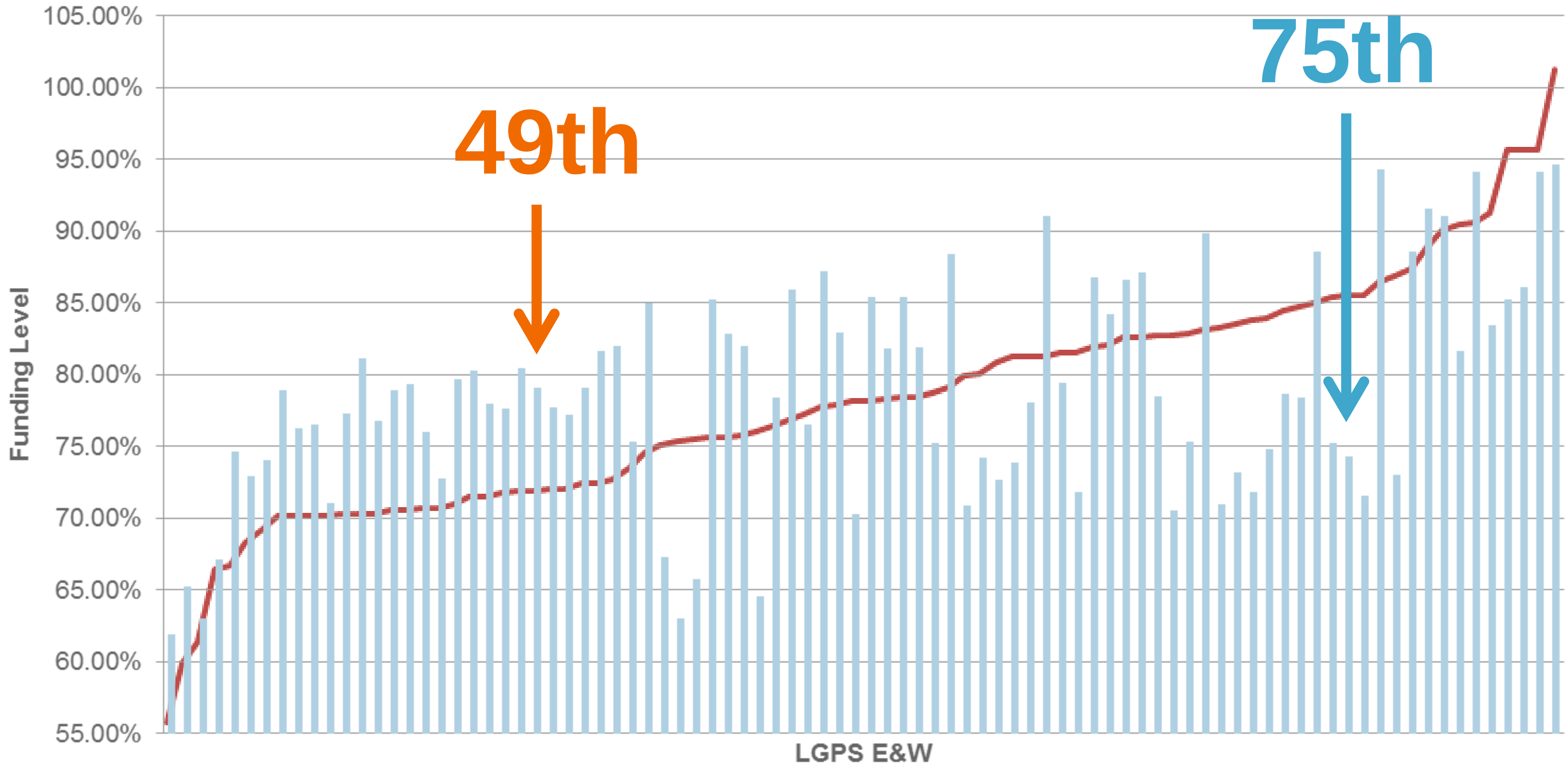
2013 funding levels (published)



Based on local assumptions

Source: All English & Welsh LGPS Funds, values based on 31 March 2013 published valuation data

2013 funding levels (same investment return)



Based on standardised assumptions

Source: Hymans Robertson; all English & Welsh LGPS Funds, **estimated** values based on 31 March 2013 published valuation data

Basis: HM Treasury standard basis, Net Discount Rate = 0.25% p.a. pre retirement / 3.0% p.a. post retirement

Management

Outputs from a traditional valuation …

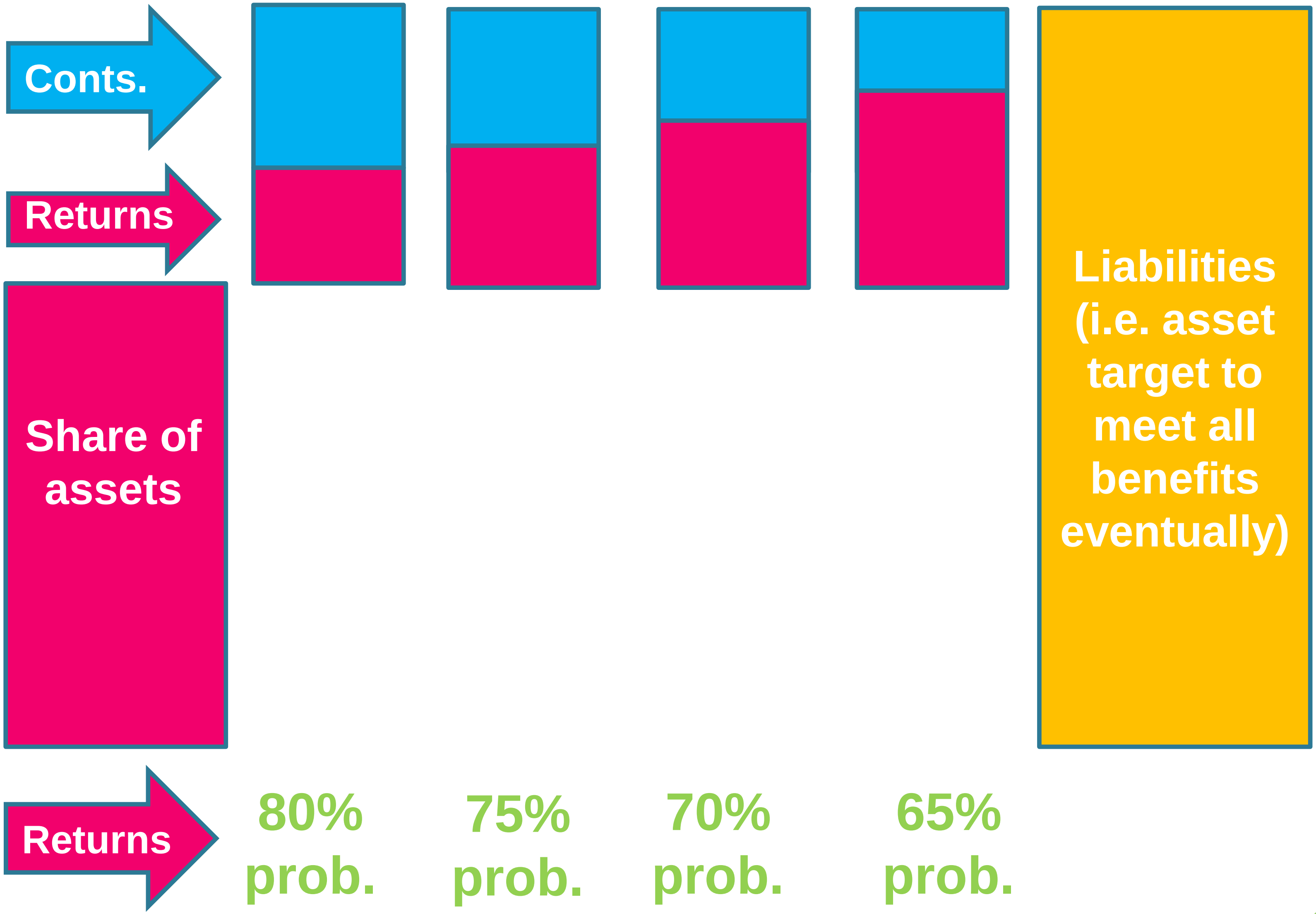
- Whole fund results
  - Balance sheet (solvency position)
  - Common contribution rate (no longer required)
- Individual employer results
  - Balance sheet and deficit
  - Calculated contribution rate
- All calculated on a single set of assumptions

Don’t base contributions on a single answer

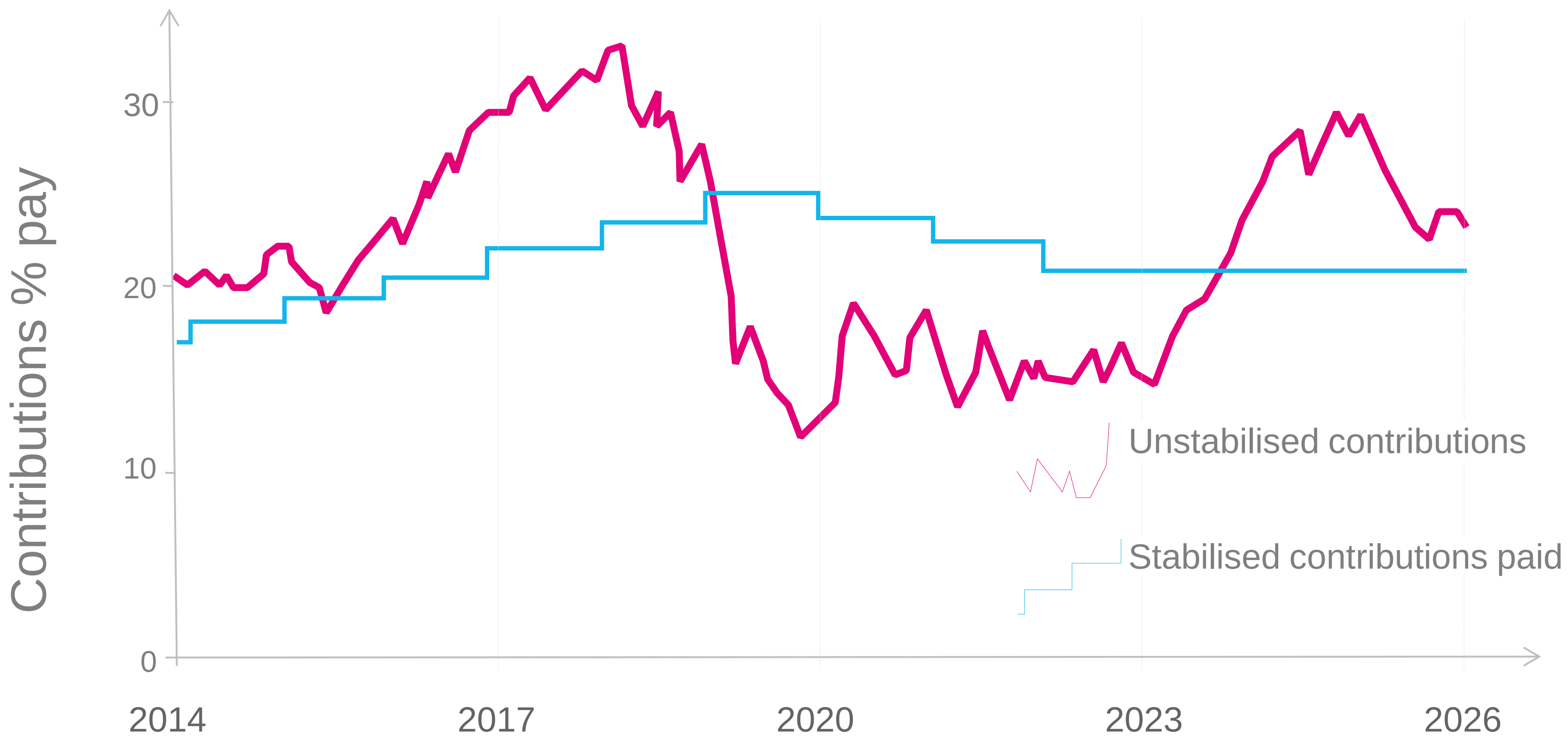
Don’t base contributions on a single answer

- Snapshot is bound to be wrong (we just don’t know in what direction & by how much!)
- Model gives more information to allow better decision making
- Where to strike the balance?

Contributions vs probability



Stabilised contributions



Recognise uncertainty when setting rates

Summary

- Funding level similar to 2013 levels
- Assumptions – market conditions and analysis will inform
- Contributions will remain affordable and stable
- But still in a challenging environment

Thank you

Any questions?